The Public Utility Holding Company Act

Its Protections Are Needed Today More Than Ever

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Foreword

The Public Utility Holding Company Act of 1935 (PUHCA) was enacted to protect investors, consumers, and the public interest from exploitation by utility holding companies and their electric and gas utility monopoly subsidiaries. An exhaustive investigation by the Federal Trade Commission that preceded enactment of PUHCA revealed fraudulent accounting practices that resulted in losses for investors in utility holding companies. Through various practices, these same holding companies were able to increase rates for customers of the operating electric or gas utilities, and used money from these captive customers to prop up failing holding company ventures. The public interest was challenged when the collapse of the utility holding company empires threatened the stability of this critical component of the country's infrastructure.

PUHCA was enacted to prevent a recurrence of these events by ensuring proper financial and structural regulation of utility holding companies, with enforcement responsibilities assigned to state utility commissions or the Securities and Exchange Commission (SEC). (Rate regulation was entrusted to the Federal Power Commission, now the Federal Energy Regulatory Commission, under the Federal Power Act of 1935. PUHCA and the Federal Power Act were companion bills that, taken together, were intended to ensure effective regulation of all aspects of utilities and utility holding companies.)

Under PUHCA, those utility holding companies that could be regulated effectively by state commissions were able to obtain an exemption from SEC regulation (subject to withdrawal by the SEC if necessary to protect the interests of investors, consumers, or the public interest). Multistate holding companies that could not be regulated effectively by state commissions were subject to regulation by the SEC in certain respects. Further, PUHCA described what utility holding companies could and could not do (they were to be focused primarily on businesses related to the utility business) and where such activities could be pursued (far-flung holding company empires with utility operations that were not physically connected with each other, for example, were prohibited). Holding companies that could not comply with PUHCA requirements were broken up by the SEC. The SEC's aggressive enforcement of PUHCA resulted in the creation of a financially sound electric utility industry free from the abusive practices of the 1920s and 1930s.

Perhaps the Act was too successful. Policymakers either forgot why PUHCA was enacted, or assumed that it had accomplished its job and could be repealed. The SEC has supported PUHCA repeal since the early 1980s, but Congress refused to follow the advice of the SEC. In 1992 Congress enacted a partial repeal of PUHCA. The Energy Policy Act of 1992 provided that the Act would not apply to developers of independent power generation facilities, called Exempt Wholesale Generators, whether they were owned by operating utilities, utility holding companies, or parties not involved in the electric utility business. As a result, a substantial number of electric utilities and utility holding companies took advantage of this new freedom from SEC scrutiny and created independent, unregulated power production subsidiaries. The financial problems of many electric utilities and utility holding companies today can be traced directly to the partial repeal of PUHCA in 1992.

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The Public Utility Holding Company Act: Its Protections Are Needed Today More Than Ever

The Public Utility Holding Company Act of 1935 (PUHCA) was enacted to protect investors and consumers from exploitation by utility holding companies and their electric and gas utility monopoly subsidiaries. The Securities and Exchange Commission (SEC) was formed and successfully used the act's provisions to dismantle the massive holding company empires of the 1930s. However, partial repeal of PUHCA by Congress with its Energy Policy Act of 1992, combined with almost nonexistent SEC enforcement in the last decade, has resulted in the return of many of the pre-PUHCA era problems.

Today, consumers and investors are not being protected from utility companies' financial manipulations and anticompetitive practices.

Today, consumers and investors are not being protected from utility companies' financial manipulations and anticompetitive practices. The Enron story is an excellent illustration, as its dramatic rise has been revealed as a fraud—based largely on deceptive accounting practices—and its collapse wiped out the retirement savings of utility employees and other investors. However, Enron is not a unique, or even unusual, case—just the first and most spectacular example.

To remedy the situation, the regulatory safeguards established by PUHCA must be enforced. In addition, Congress should consider how the law could be strengthened to provide effective oversight of the current energy industry.

PUHCA Enacted to Protect Investors and Consumers

PUHCA was a direct response to the tremendous growth and harmful practices of utility holding company systems throughout the booming 1920s and the subsequent collapse of many of these systems. The expansion took the form of buying up gas and electric utility systems, as well as diversifying into other, unrelated businesses. The collapse revealed numerous financial and accounting abuses that hid from investors and consumers the companies' true financial status. Since there was no federal oversight of these monopolies, regulation resided in the hands of state commissions, which could not control the actions of a holding company or any of its subsidiaries organized in other states.

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PUHCA's goal was to protect consumers and investors by establishing effective regulation over multistate utility holding companies. Exemptions to many of the act's provisions were provided to utility holding companies that operated substantially in one state, as state regulators were presumed to have adequate authority and access to the necessary information to effectively oversee these companies.

Congress identified several classes of problems that it sought to remedy. Not coincidentally, this same list of problems characterizes the current energy industry:

- Lack of investor information;
- Incorrect valuation of assets and earnings;
- Improper pricing of interaffiliate transactions;
- No relationship between a company's expansion and operational efficiencies; and
- Subsidiaries and affiliates in different states, making effective regulation difficult.

The first two items address financial reporting and practices. The 1929 stock market crash revealed the shaky financial structure of many utility holding companies. Thus, Congress was concerned that decisions to invest in these companies had been based on financial statements that did not reflect the companies' true condition. Abuses included fictitious or unsound asset values, and revenues inflated by excessive predictions of income from utility subsidiaries.

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The PUHCA remedy provided SEC oversight of all securities issued by the holding company and its subsidiaries. The SEC must consider several reasonableness and public interest standards, such as ensuring that securities are reasonably adapted to the earning power of the company and that the financing is appropriate for the economical operation of the business.

Congress was concerned about improper pricing of interaffiliate transactions, the third item in the list above, because it recognized that subsidiaries within the same corporation could not realistically be expected to deal at arm's length. One of the holding company evils identified in PUHCA was an affiliate's excessive charges to a utility for items such as services, construction work, equipment and materials. Another concern was the misallocation of overhead or joint costs.

PUHCA's remedy required that contracts between service companies and the utility be performed economically and efficiently at cost-based rates, and that loans or extension of credit from a utility company to its holding company be prohibited. In addition, the SEC was given rulemaking authority over other types of affiliate transactions, including loans to affiliate companies and the payment of dividends.

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The final two items on the list address corporate structure and expansion. Congress was concerned that the holding companies were acquiring nonintegrated operating utilities without regard to economic efficiency or coordination of management, and that this resulted in lack of effective control by state regulatory agencies. Pyramiding holding companies—structures in which there were numerous layers of ownership—made it difficult, if not impossible, for investors and regulators to determine the company's true financial health.

The PUHCA remedy required utility acquisitions to be physically integrated and truly coordinated with existing utility property and to create positive operational benefits. In addition, holding company businesses must be reasonably incidental or appropriate to the operations of the utility.

Energy Policy Act Amendments Partially Repeal PUHCA

The introduction of some competition into wholesale power markets brought changes to PUHCA. The 1978 Public Utility Regulatory Policies Act required utilities to purchase power from qualifying facilities (QFs)—generally cogeneration facilities and other small power producers—and defined most of these QFs as nonutilities under PUHCA.

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However, it was with the enactment of the 1992 Energy Policy Act and its partial repeal of PUHCA that the safeguards in the 1935 law were weakened significantly. The financial problems of many electric utilities and utility holding companies today can be traced directly to this partial repeal of PUHCA in 1992.

In an effort to promote wholesale competition generally, Congress included in the Energy Policy Act specific provisions that established a new category of generation owners—exempt wholesale generators (EWGs). Upon the Federal Energy Regulatory Commission's (FERC) certification of EWG status, these entities could sell power at market-based—as opposed to cost-based—rates, and could be owned by electric utility companies as long as the EWG did not operate in the utility's own service territory. Also, EWGs could avoid standard government reporting provisions because they were defined—for the purposes of PUHCA enforcement—as nonutilities, so that ownership of an EWG by a holding company did not violate the integration provision of PUHCA.

…these new provisions allowed utility holding companies to purchase or build generating projects all over the world and to invest in all types of utility facilities outside of the U.S.

Another purpose of the EWG amendments was to allow companies not otherwise involved in the utility industry to purchase EWGs without being subject to PUHCA. Prior to the Energy Policy Act, companies that wanted to enter the power production business were subject to PUHCA regulation unless they structured their ownership in specific ways—in general, by limiting ownership to less than 10 percent of a generating facility or by owning a QF.

The Energy Policy Act also enabled holding companies to own foreign utility companies. Taken together, these new provisions allowed utility holding companies to purchase or build generating projects all over the world and to invest in all types of utility facilities outside of the U.S.

PUHCA Further Weakened by SEC Interpretations and Lack Of Enforcement Generally

In 1997 the SEC adopted Rule 58, which allows registered holding companies to own energy-related companies, including electricity marketing and brokering companies, as long as the investment does not exceed defined dollar and percentage caps. This facilitated the companies' forming, via restructuring or acquisition, separate subsidiary companies for different functions, such as utility services, fuel procurement, or engineering design.

Next, the SEC applied increasingly lenient interpretations of PUHCA's requirement that a company's utility properties be integrated. This resulted in approval of mergers between companies with no physical connection at all. Instead, the SEC relied on tenuous physical connections, such as via small connector lines or even transmission systems owned by other entities. Thus, for example, it approved the Northern States Power Company (Minnesota and Wisconsin) merger with New Century Energies (Colorado, New Mexico, Texas) to form Xcel Energy; the PECO (Pennsylvania) merger with Unicom Corp. (Illinois) to form Exelon Corp.; and the American Electric Power Co. (Kentucky, Michigan, Ohio, Virginia, West Virginia) merger with Central and South West Corp. (Arkansas, Louisiana, Oklahoma, Texas).

> …the effects of all this activity were obvious: huge growth in the number of holding company subsidiaries, the return of pyramiding corporate structures, and loss of information necessary for oversight evaluations.

Throughout the 1990s, utilities diversified into other businesses, including telecommunications, and several foreign utility companies purchased major U.S. utility assets. By 2002, the effects of all this activity were obvious: huge growth in the number of holding company subsidiaries, the return of pyramiding corporate structures, and loss of information necessary for oversight evaluations.

The number of registered holding company subsidiaries is now far greater than in 1938 when the SEC began PUHCA enforcement. At that time there were 214 utility holding companies owning

1,976 subsidiaries.[1] In 1992, when the first new registered holding company in over 25 years was formed, there was a total of 14 registered holding companies. By 2002, there were 28 registered holding companies that owned 37 additional registered holding company subsidiaries as well as another 6,099 subsidiaries.[2] Of the 28 companies, four (E. ON, Emera Inc., National Grid Group, and Scottish Power) are foreign companies. See **APPENDIX A** for a current list of all 65 registered holding companies.

There are also several exempt holding companies with electric utility subsidiaries, including many—AES Corp., CMS Energy, Enron—that are currently experiencing severe financial problems because of speculative over-expansion and the collapse of energy trading markets. Typically, a utility holding company's exemption from most PUHCA provisions is based on the SEC's determination that the company's business is primarily intrastate in nature, and therefore subject to effective state regulation. However, in many states, retail choice legislation led directly to reduced regulatory oversight of utilities. Thus, many state commissions now have less authority over utility companies, while the companies themselves are more difficult to monitor—the result of increasingly complex holding company structures.

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Concern over the ability of state regulators to adequately regulate utilities was evident by 1995, as the SEC admitted in its report on the status of PUHCA regulation:

> *As the Virginia Commission notes, some exemptions may be based on a faulty premise of effective state regulation. It explains that it may not have authority to approve all financing transactions of utility holding companies; regulatory powers over the holding*

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1 Charlie Higley, Public Citizen, "Money Harvest: Utility Holding Companies Are Threshing Ratepayers," published May 1999, p 33.

2 Securities and Exchange Commission, Office of Public Utility Regulation, "Financial and Corporate Report: Registered Holding Companies Under *The Public Utility Holding Company Act of 1935*," October 2002. Note that the subsidiary listings of one company, E. ON, take up 78 pages of the report.

company are derived from authority over its utility subsidiary. Such regulatory authority, the Virginia Commission concludes, is far from a complete substitute for the authority granted to the SEC under the Act.[3]

Pre-PUHCA Legislation Abuses Surface Again

In 2002 the spot-light was once again on energy companies and their exploitation of consumers and investors.

In 2002 the spotlight was once again on energy companies and their exploitation of consumers and investors. Problems associated with lack of investor information and manipulation of asset valuation first surfaced in connection with Enron's December 2001 bankruptcy. This led to revelations of how accounting practices used by many of the large energy companies hid debt and inflated revenues. These practices included off-balance sheet financing, structuring transactions to look like sales revenue rather than loans, and booking revenues and projected profits from long-term trading contracts at the time the contract was signed.

Several companies have announced their participation in round-trip trades (mirror-image trades with the same counterparty), which serve to increase revenue artificially. CMS Energy has admitted to round-trip or "wash" trades in excess of $4 billion. In another case, Allegheny Energy Corp., a registered holding company, purchased a trading company from Merrill Lynch and is now suing Merrill Lynch. Allegheny claims that the price paid for the trading company was based on revenues inflated by round-trip transactions.

In addition, concerns about affiliate abuse, similar to those motivating PUHCA's enactment, have resurfaced. Examples include a regulated utility lending money to an unregulated affiliate (Arizona Public Service and Pinnacle West Energy Corp.), and a regulated utility purchasing power plants from an unregulated affiliate, despite opposition of consumer advocate groups that claim the plants are unprofitable (Public Service Company of Indiana and Cinergy Capital

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3 Securities and Exchange Commission, Division of Investment Management, *The Regulation of Public-Utility Holding Companies*, June 1995, p. 107.

and Trading). In August 2002, FERC issued a proposed rule to restrict cash management and money pooling arrangements between FERC-regulated utilities and their holding companies. The proposal results from a FERC investigation into accounting practices that may have harmed regulated companies while benefiting corporate parents.[4]

[The proposed rule] results from a FERC investigation into accounting practices that may have harmed regulated companies while benefiting corporate parents.

Most recently, at a FERC technical conference on capital availability for energy markets, a bond insurance company recommended that FERC use its authority over new financings and look at how the debt will be used within the corporation and how it will affect existing bondholders. MBIA Insurance Corp. vice president Kara Silva, noting that holding companies may use regulated utility assets to prop up unregulated ventures, stated:

> *I can attest to the fact that these financial activities are taking their toll on the regulated [investor-owned utility] sector. By taking a stronger role in investigating issuances where utility assets are used to collateralize non-core investments, the commission can…protect against shifts in capital that harm utility investors and ratepayers.*[5]

Finally, the huge increase in mergers and acquisitions—both within the electric utility industry and with companies in other energy fields, domestic as well as foreign—has been motivated by corporate egos and achieving size, rather than by improving operational efficiencies. It also has resulted in a proliferation of unregulated subsidiaries, and thus made it more difficult for state and other regulators to monitor company activities that affect the regulated utility.

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4 "FERC Finds 'Severe' Record-Keeping Problems, Sets Stiffer Regulations," *Electric Utility Week*, published August 5, 2002; and FERC's Accounting Release Number AR-17, issued August 1, 2002.

5 Tina Davis, "FERC Advised To Keep Tabs On Utility Debt Issuances To Detect Cross-Subsidization," *The Energy Daily*, published January 24, 2003; reporting on the Federal Energy Regulatory Commission's January 16, 2003, technical conference on capital availability for energy markets.

Over-expansion has led to large debt burdens, poor stock performance, and lower credit ratings. Many energy companies are selling their assets in an attempt to raise cash, and avoid further credit downgrades or bankruptcy. For example, in October NiSource announced its plan to sell Columbia Energy Resources, its natural gas subsidiary acquired only two years earlier, and in November Alliant Energy announced that it hopes to raise $800 million or more through the sale of its noncore businesses. NRG, the unregulated generation company subsidiary of Xcel, has reported sales agreements for more than $750 million in assets. In summer 2002, Dynegy, which owns Illinois Power Co., announced the sale of its Northern Natural Gas subsidiary; the sales price reflected a loss on the asset of almost $600 million. In addition, American Electric Power Co., Progress Energy, and other companies are getting out of, or cutting back on, the risky merchant trading business and supporting assets.

[Merger and acquisition] over-expansion has led to large debt burdens, poor stock performance, and lower credit ratings.

Financial Distress in 2002

The industry's poor financial state is evidenced by the large drop in the companies' stock prices and credit ratings. Throughout the second half of the 1990s investors bought energy company stocks based on large reported profits and strong balance sheets. By 2002, stock prices had fallen dramatically—in some cases to $1 per share or less—causing huge losses for investors. (See **APPENDIX B** for the 2002 performance of selected electric utility stocks.)

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This fall in utility stock prices is not solely a result of the poor performance of the stock market as a whole. In 2001 and 2002 the Dow Jones Utility Average recorded its two largest declines since 1937. As shown in the following chart, the utility sector drop was significantly worse than the decline in the industrial sector.

Dow Jones Index Comparison

	Dow Jones Industrial		Dow Jones Utility	
Year-End	Index	% Change	Index	% Change
2000	**10,788**		**412**	
2001	**10,022**	**-7.1**	**294**	**-28.7**
2002	**8,342**	**-16.8**	**215**	**-26.8**

Utility holding companies have suffered numerous credit rating downgrades as the result of huge amounts of debt incurred by nonutility subsidiaries. The following chart shows the steep decline in Standard & Poor's utility industry ratings over the last two years.[6]

Standard & Poor's Utility Ratings Summary

	Percent of Utilities Rated:		
	A or Above	BBB Category	Below Investment Grade
Year-end 2000	**51%**	**37%**	**5%**
End of June 2001	**55%**	**39%**	**4%**
Year-end 2001	**51%**	**43%**	**6%**
End of June 2002	**43%**	**51%**	**6%**
Year-end 2002	**38%**	**44%**	**18%**

The weakened financial condition of energy companies clearly hurts both investors, who have lost billions of dollars, and consumers, who will pay higher rates as the result of utility companies' lower credit ratings and higher cost of debt. Financial stress also motivates a holding company to draw additional money and reallocate generating and other assets from its regulated operating utility. For example, the

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[6] Barbara Eiseman, Standard & Poor's, "U.S. Utilities' Credit Quality Displayed Steep Decline in 2001; Negative Trend Likely to Continue," published January 2002; "Credit Quality for U.S. Utilities Continues Negative Trend in Second Quarter," published July 2002; and "U.S. Power Industry Experiences Precipitous Credit Decline in 2002; Negative Slope Likely to Continue," published January 2003. Beginning with year-end 2001, A or Above category includes A- ratings.

utility may be required to reduce capital spending or cut back on expenses to free up cash for its parent company. The growing support from utility subsidiaries is discussed more fully in a December 26, 2002, article in *The Wall Street Journal*. (See **APPENDIX C** for the text of the article.)

Holding or Affiliate Company's Financial Distress Damages Operating Company Viability

The rating agencies' method of assessing credit makes it clear that the financial fate of a holding company and its subsidiaries are linked closely. A holding company's investment in high risk or ultimately unprofitable ventures leads to lower credit ratings, and lower ratings at the holding company level inevitably result in credit downgrades to the utility company. This raises the utility's cost of capital and ultimately hurts the utility customer, because the cost increase can be passed on to the customer through higher rates.

Moody's Investors Service noted back in 1998:

> *The appearance of numerous new subsidiaries, concurrent with heightened risk from nonregulated businesses, complicates the holding company credit profile. And it complicates credit analysis with regard to the utility operating company. It is now rare that a utility can be analyzed based upon its own credit fundamentals alone.*[7]

An April 2000 Moody's article described the growth of parent company debt from a series of large acquisitions—termed "creeping leverage" by Moody's. In addition to identifying the increasing use of nontraditional forms of debt, such as off-balance sheet financing and leasing structures, the article highlighted the potential effect of the larger holding company debt on the operating utility:

> *First, the spread between the parent rating and the operating company unsecured rating has widened in many cases beyond*

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[7] Moody's Investors Service, Global Credit Research, "Ratings Gap Between Electric Utilities and Their Holding Companies Widens," March 1998, p. 3.

> *the one notch…. Second, since the utility or operating company dividends are so critical to parent debt service, impairment to the operating companies' financial flexibility will likely be reflected in its own rating. The parent can scarce afford to reduce the operating company's dividend in these cases, reducing the operating company's dividend's role as a source of financial flexibility for the operating company.* [8]

A recent Fitch Ratings report summarizes the outlook for 2003 and identifies the major risks for various sectors of the energy industry. (See **APPENDIX D** for Fitch ratings for selected utility companies and estimates of holding company debt.)[9]

Fitch assigns a negative outlook to 40 percent of utility parent companies, 24 percent of integrated utilities, and 15 percent of distribution utilities. The major risk identified for each of these groups relates to the financial health of related companies. Wholesale affiliates are the major risk for utility parent companies, while parent company risk is the major concern for both integrated utilities and distribution companies.

Aquila provides a good example of a utility parent company at risk because of the credit problems of a subsidiary. The company expanded rapidly prior to 2002, building its merchant trading business and receiving numerous PUHCA exemptions to acquire utility assets in New Zealand, Australia, and the United Kingdom. However, since its trading subsidiary developed huge liquidity problems in early 2002, Aquila has sold almost $1 billion in assets, and closed down the trading business. The Missouri Public Service Commission (PSC) staff recently concluded that, given Aquila's poor financial health, the PSC should begin now to address the potential effects of bankruptcy. Staff noted that the PSC would have little

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[8] Moody's Investors Service, Global Credit Research, "Creeping Leverage: Growth in Electric Holding Company Debt," April 2000, pp. 3–4.

[9] Fitch Ratings, "Outlook 2003: U.S. Power & Gas," December 17, 2002, and Fitch Web site (www.fitchibca.com).

ability to protect utility ratepayers if Aquila's assets were liquidated in a Chapter 7 filing.[10]

Utility ratepayers also will be in jeopardy if Aquila completes its plans to use regulatory assets as collateral for revolving credit loans currently worth $650 million.[11] If the plan goes through and Aquila subsequently defaults on the loans, assets financed by utility ratepayers would belong to Aquila's creditors.

Conclusion

"…the SEC can advise you, this morning, of its belief that adequate safeguards are provided…for the protection of the interest of investors in the securities of every type of generating company and generating system."

—March 14, 1991

PUHCA repeal debates have an argument *du jour* quality. Two decades ago, PUHCA repeal arguments were based on the need to allow utilities to diversify into nonutility businesses. A decade ago, partial repeal through the EWG exemption was based on the proposition that it would promote competition. Today, repeal is advocated based on the perceived need to enhance capital formation and support the creation of transmission companies. There has been as well a common thread running through these debates—that PUHCA is no longer required to protect investors or consumers.

Consider how support for the EWG exemption was characterized by SEC Commissioner Fleischman in testimony before the Senate Energy Committee on March 14, 1991.

> *[T]he SEC can advise you, this morning, of its belief that adequate safeguards are provided, in the disclosure requirements under the securities laws administered by the SEC and in the market itself, for the protection of the interest of investors in the securities of every type of generating company and generating system…. And the SEC can also advise you of its belief that the interest of consumers, generally, can be protected by other regulatory entities….*

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10 "Aquila's Finances Threaten Utilities, Missouri PSC Staff Says," *MegawattDaily*, December 31, 2002.

11 Steve Everly, "Aquila Files to Use Regulated Assets as Collateral in Colorado, " published in *The Kansas City Star* (Missouri), January 15, 2003.

Exempting wholesale power generators from the 1935 Act would remove unnecessary regulation and encourage competition in order to reduce the cost of electric power for consumers, and ultimately, reduce our dependence on foreign sources of energy. [12]

According to Commissioner Fleischman, nothing would go wrong if Congress were to exempt wholesale generators from PUHCA. Twelve years later we can see how wrong the Commissioner was. The litany of things that have gone wrong is startling.

…utility holding companies have been able to issue misleading financial statements, manipulate affiliate transactions, and expand with no regard for consumer costs or welfare.

Over the past decade, utility holding companies have been able to issue misleading financial statements, manipulate affiliate transactions, and expand with no regard for consumer costs or welfare. As a result, investors have suffered substantial losses. Today, many troubled utility holding companies with failed or faltering EWG investments are facing a debt crisis of staggering proportions, and consumers of these holding companies' electric utility subsidiaries stand in line to pay the price.

PUHCA oversight, while designed to eliminate these very abuses and thereby protect investors and consumers, failed in the 1990s because PUHCA's protections had been significantly undermined by the EWG exemption. Further, what remained of PUHCA was bent, twisted, or simply ignored by the SEC.

The consequences of total PUHCA repeal are no longer a matter of speculation. To see what a world without PUHCA looks like, one needs to look only at the serious, adverse consequences of the partial PUHCA repeal in 1992. Congress must insist that consumers of monopolistic utility companies with the ability to exert market power over competitors and customers be provided the effective regulatory protection promised and until recently delivered by PUHCA.

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[12] Edward H. Fleischman, Commissioner of the Securities and Exchange Commission, Oral and Written Statements, testimony before the Senate Committee on Energy and Natural Resources, March 14, 1991, published in the *Hearing Record for S. 341, National Energy Security Act of 1991*, by the U.S. Government Printing Office, 1991.

Appendices

A. Registered Holding Companies as of October 31, 2002

B. Selected Power Companies—Change in Stock Prices by Year-End 2002

C. Article from *The Wall Street Journal*

D. Fitch's Credit Ratings for Selected Utility Companies

APPENDIX A:

Registered Holding Companies As of October 31, 2002

Registered holding companies listed below are in bold; registered holding companies that are subsidiaries of other registered holding companies are indented. There are 28 top registered holding companies and 37 subsidiary registered holding companies.

1. **AGL Resources**, **Inc.,** a gas utility company, became a registered holding company with the acquisition of Virginia Natural Gas, Inc.;
2. **Allegheny Energy Inc.,** formerly known as Allegheny Power System Inc.;
    3. **Allegheny Energy Supply Co, LLC;**
4. **Alliant Energy Corp.**, result of merger between IES Industries (parent of IES Utilities), Interstate Power Co., and WPL Holdings (parent of Wisconsin Power & Light Co.);
5. **Ameren Corp.**, result of merger between CIPSCO (parent of Central Illinois Public Service Co.) and Union Electric Co.;
6. **American Electric Power Company, Inc.** acquired a registered holding company:
    7. **Central and South West Corp.;**
8. **CenterPoint Energy Inc.**, result of reorganization of Reliant Energy Inc.;
    9. **Utility Holding LLC**;
10. **Cinergy Corp.**, result of merger between Cincinnati Gas & Electric Co. and PSI Resources Inc. (parent of PSI Energy);
11. **Dominion Resources Inc.** (parent of Virginia Electric & Power Co.) acquired a registered holding company:
    12. **Consolidated Natural Gas Company;**

13. **E.ON AG**, German company that acquired PowerGen, which owns electric facilities in the United Kingdom, and LG&E Energy Corp. (holding company for Louisville Gas & Electric Co. and Kentucky Utilities);
    14. **E.ON US Verwaltungs GmbH;**
    15. **E.ON UK Verwaltungs GmbH;**
    16. **E.ON UK plc**;
    17. **PowerGen plc**;
    18. **Powergen US Holdings Limited;**
    19. **Powergen US Investments Limited;**
    20. **Ergon US Investments Limited;**
    21. **Powergen Luxembourg sarl;**
    22. **Powergen Luxembourg Holdings sarl;**
    23. **Powergen Luxembourg Investments sarl;**
    24. **Powergen USA;**
    25. **Powergen US Investments Corp.;**
26. **Emera Inc.**, result of NS Power Holdings' (parent of Nova Scotia Power) acquisition of Bangor Hydro-Electric Co.;
    27. **Emera US Holdings Inc.;**
    28. **BHE Holdings Inc.;**
29. **Energy East Corp.**, result of merger between New York State Electric & Gas Corp. and CMP Group (parent of Central Maine Power Co.);
30. **Entergy Corp.**;
31. **Exelon Corp.**, result of merger of PECO Energy Company and Unicom Corp. (parent of Commonwealth Edison);
    32. **Exelon Energy Delivery Company LLC**;
    33. **Exelon Generation Company LLC**;
    34. **Exelon Ventures Company LLC**; and
    35. **PECO Energy Power Company** (formerly known as Philadelphia Electric Power Company), subsidiary of PECO Energy Company;

36. **FirstEnergy Corporation** became a registered holding company as the result of its merger with GPU Inc. (formerly known as General Public Utilities Corp.);

37. **Great Plains Energy Inc.**, which owns Kansas City Power & Light, an electric utility, and Great Plains Power, a power generator and marketer, became a registered holding company as a result of a 2001 reorganization;

38. **KeySpan Corp.**, which owns generating facilities and a gas distribution utility, became a registered holding company with the acquisition of two more gas distribution utilities, EnergyNorth Inc. and Eastern Enterprises;

39. **National Fuel Gas Company**;

40. **National Grid Group plc**, a transmission company in the United Kingdom, became a registered holding company upon the acquisition of a registered holding company, New England Electric System; and subsequently acquired another registered holding company, Eastern Utilities Associates;

    41. **National Grid (US) Holdings Limited;**

    42. **National Grid (US) Investments;**

    43. **National Grid (Ireland)1 Limited;**

    44. **National Grid (Ireland) 2 Limited;**

    45. **National Grid General Partnership;**

    46. **National Grid USA;**

    47. **National Grid Holdings One plc;**

    48. **National Grid (US) Investments 4;**

    49. **National Grid (US) Partner 1 Limited;**

    50. **National Grid (US) Partner 2 Limited;**

    51. **National Grid Holdings Inc.;**

52. **NiSource Inc.** acquired a registered holding company:

    53. **Columbia Energy Group**, formerly known as Columbia Gas System Inc.;

54. **Northeast Utilities System;**

55. **Pepco Holdings Inc.** acquired a registered holding company:
    56. **Conectiv**, result of merger between Atlantic City Electric Co. and Delmarva Power & Light Co.;
    57. **Conectiv Energy Holding Co.;**
    58. **ACE Reit Inc.;**
59. **Progress Energy Inc.**, result of merger between Florida Progress Corp. (parent of Florida Power Corp.) and CP&L Energy (parent of Carolina Power & Light Co.);
60. **SCANA Corp.**, parent of South Carolina Electric & Gas Co., acquired Public Service Company of North Carolina, a gas distribution company;
61. **Scottish Power plc**, an electric distribution company in the United Kingdom, acquired PacifiCorp;
62. **The Southern Company;**
63. **UNITIL Corp.;**
64. **WGL Holdings, Inc.**, parent of Washington Gas Light Company, reorganized and became a registered holding company;
65. **Xcel Energy, Inc.,** result of merger between Northern States Power Co. and New Century Energies, a registered holding company created from the 1997 merger of Public Service Company of Colorado and Southwestern Public Service Co.

Source: U.S. Securities and Exchange Commission, "Financial and Corporate Report, Registered Holding Companies Under The Public Utility Holding Company Act of 1935, October 31, 2002."

APPENDIX B: Selected Power Companies—Change in Stock Prices by Year-End 2002

	Stock Price			Percent Change	
	2-Jan-01	2-Jan-02	31-Dec-02	Last Year	Last 2 Years
Registered Holding Companies					
Allegheny Energy Inc.	42.08	34.37	7.56	-78%	-82%
CenterPoint Energy Inc.	38.78	25.43	8.50	-67%	-78%
Xcel Energy Inc.	25.32	26.61	11.00	-59%	-57%
Alliant Energy Corp.	31.00	30.63	16.99	-45%	-45%
Northeast Utilities System	23.56	18.00	15.49	-14%	-34%
American Electric Power Co. Inc.	41.25	41.96	27.33	-35%	-34%
NiSource Inc.	30.12	23.51	20.00	-15%	-34%
Exelon Corp.	67.88	48.48	53.79	11%	-21%
Pepco Holdings Inc.	24.27	22.69	19.55	-14%	-19%
Dominion Resources Inc.	65.56	60.75	55.77	-8%	-15%
Great Plains Energy Inc.	26.69	25.20	22.99	-9%	-14%
Southern Company	32.25	25.50	28.39	11%	-12%
KeySpan Corp.	40.44	35.11	35.89	2%	-11%
Progress Energy	48.44	45.31	44.03	-3%	-9%
UNITIL Corp.	26.75	23.40	24.88	6%	-7%
Ameren Corp.	45.19	42.75	42.28	-1%	-6%
Cinergy Corp.	34.13	33.65	33.72	0%	-1%
SCANA Corp.	29.25	27.99	31.36	12%	7%
FirstEnergy Corp.	30.63	35.12	33.00	-6%	8%
Entergy Corp.	41.75	39.80	46.70	17%	12%
Energy East Corp.	19.31	19.16	22.68	18%	17%
Exempt Holding Companies and Electric Utilities					
Dynegy Inc.	50.37	25.81	1.18	-95%	-98%
AES Corp.	51.75	16.79	3.02	-82%	-94%
Aquila Inc.	25.50	23.23	1.77	-92%	-93%
NorthWestern Corp.	22.31	21.40	5.29	-75%	-76%
CMS Energy Corp.	27.20	23.00	9.44	-59%	-65%
Westar Energy	25.38	17.75	10.00	-44%	-61%
TXU Corp.	43.06	47.72	18.68	-61%	-57%
DQE Inc.	32.00	19.69	15.68	-20%	-51%

	Stock Price			Percent Change	
	2-Jan-01	2-Jan-02	31-Dec-02	Last Year	Last 2 Years
Exempt Holding Companies and Electric Utilities (continued)					
Duke Energy Corp.	39.24	38.78	19.54	-50%	-50%
TECO Energy	31.12	26.67	16.17	-39%	-48%
IdaCorp Inc.	43.36	38.78	24.83	-36%	-43%
Avista Corp.	19.25	13.79	11.80	-14%	-39%
Sierra Pacific Resources	55.35	53.52	34.50	-36%	-38%
Constellation Energy Group	42.06	26.49	27.82	5%	-34%
Public Service Enterprise Group	46.69	43.07	32.98	-23%	-29%
Pinnacle West Capital Corp.	46.37	42.43	34.09	-20%	-26%
PG&E Corp.	19.56	19.45	14.61	-25%	-25%
FPL Group	70.25	56.95	61.33	8%	-13%
El Paso Electric Co.	12.94	14.85	11.80	-21%	-9%
Sempra Energy	22.50	24.77	24.37	-2%	8%
WPS Resources Corp.	35.50	36.53	39.32	8%	11%
Consolidated Edison Inc.	37.56	40.78	43.25	6%	15%
Wisconsin Energy Corp.	22.00	22.89	25.65	12%	17%
DTE Energy Co.	38.25	42.37	46.98	11%	23%

Source: Closing stock price as reported on Yahoo Finance Web site.

APPENDIX C:
Article from *The Wall Street Journal*

Beleaguered Energy Firms Try To Share Pain With Utility Units

By Rebecca Smith
The Wall Street Journal
Thursday, December 26, 2002

Energy companies, burned by disastrous forays into commodities trading and other unregulated businesses, are increasingly seeking to pass some of the financial burden on to their utility units, and some experts are worried that this could lead to higher electricity rates for consumers in coming years.

Utilities, the boring-but-steady companies that provide electricity to homes and businesses, are among the few players to have survived the meltdown of the nation's $200 billion energy sector largely unscathed. Many of the utilities' parent companies would like to take advantage of these units' relative financial health to prop up other, troubled subsidiaries. Utilities are being nudged to buy assets from affiliates, make loans to down-at-the-heel siblings or pass more money to their parent companies.

The industry's plunging fortunes, symbolized by the collapse into bankruptcy of Enron Corp. last year, sparked new vigilance on the part of regulators, who are jumping on some of these questionable activities. Duke Energy Corp. recently agreed to pay $25 million to its utility customers to settle regulators' accusations that the company improperly stuck its utilities with expenses that rightfully belonged to unregulated affiliates. Duke, of Charlotte, N.C., didn't admit to any wrongdoing.

In many cases, though, regulators can do little to prevent energy holding companies from milking their utility units. As deregulation swept the nation in the late 1990s, state legislatures often clipped the wings of regulatory commissions to save money and give emerging markets more breathing room. The commissions were left understaffed. With little or no authority to review the books and records of the unregulated businesses, they now only see part of the picture.

"The sector has totally hit the wall," says Michael Valocchi, head of the utility practice at IBM Consulting Services in Philadelphia. "And now utilities are being expected to make up for losses on the unregulated side." Mr. Valocchi says his utility clients tell him they are under orders to cut capital spending by as much as 30% in 2003, in some cases to free up funds that can be passed to holding company parents.

These companies' needs are great. In the third quarter alone, problems at the unregulated units of AES Corp., Allegheny Energy Inc., Aquila Inc., Dynegy Inc., TXU Corp., Westar Energy Inc. and Xcel Energy Inc. wiped out more than $14 billion of balance-sheet capital through losses and charges. Moreover, the sector built up huge debts from its expansion in the 1990s into such businesses as telecommunications, power generation and, in one case, a home-security company. More than $25 billion of debt must be repaid industrywide next year.

Credit-rating agencies, recognizing that utilities are vulnerable to their parents' woes, have cut debt ratings for these subsidiaries, along with slashing the ratings on the parent companies. More than two dozen utilities covered by rating agency Fitch are rated at junk status, making it difficult and costly to refinance debt. For the time being, higher financing costs will mostly be borne by holding company shareholders.

But analysts say it is likely that utilities eventually will argue to regulators that their higher cost of capital warrants increases in the rates they charge electricity customers.

Some utilities have responded to the added financial burdens by reducing spending on new equipment and routine maintenance, moves that could impair service and safety. In the early 1990s, California's Pacific Gas & Electric Co., a unit of PG&E Corp., reduced its tree-trimming and maintenance expenditures. The result: Winter storms in 1995 toppled rotten power poles and felled overgrown trees onto transmission lines, causing record power outages in Northern California. Storm-related outages in the state this month appear likely to trigger an investigation, even though the utility says it hasn't scrimped on spending since seeking bankruptcy protection a year and a half ago.

Regulated utilities achieved their modern form by the late 1920s, when laws gave them monopoly territories in exchange for an obligation to provide safe and reliable service. A 1935 federal law set restrictions on how much cash parent holding companies could suck out of utility units.

But by the late 1990s, state and federal governments were chipping away at such legal limitations and wholesale and retail power markets were being opened to competition. Holding companies got opportunities to branch into new, unfettered businesses. Regulators assumed that if things went awry on the unregulated side, utilities would be shielded from those losses.

But that isn't the way it is working out. Consider the case of Westar Energy of Topeka, Kan. Last month, the Kansas Corporation Commission, the state's utility regulator, took the unusual step of ordering the company not to cause harm to its two Kansas utilities, Kansas Gas & Electric and Kansas Power & Light. The directive came after regulators found that Westar had quietly shifted more than $1.95 billion of debt onto the utility side of the business, by arranging intercompany loans and other means. The commission says it wants complete legal and financial separation of Westar's utilities from the rest of its enterprises, and especially from Protection One Inc. That Westar unit, a home-security firm, contributed $1.03 billion in losses and charges to Westar's bottom line from 1997 through this year's third quarter. Commission Chairman John Wine says utility holding companies "can go pretty far down the road of commingling utility assets before it gets detected." He says he is worried about the eventual impact on utility service and rates.

Other energy holding companies are relying on their utilities for help more openly than Westar. Cincinnati-based Cinergy Inc. in mid-December got regulatory approval to transfer two power plants from an unregulated unit, Cinergy Capital & Trading, to its utility, Public Service of Indiana, for more than book value of about $500 million. Similarly, Pinnacle West Capital Corp., of Phoenix, is seeking permission to borrow as much as $500 million from its regulated utility, Arizona Public Service, or to get the utility to back such a loan. It has gotten the go-ahead from state regulators to borrow $125 million so far. Both companies in recent years built up energy-generation and trading units that haven't developed as expected.

One of the clearest examples of a lack of firewalls between utilities and unregulated affiliates came at Duke Energy. In July 2001, a Duke accountant contacted regulators to complain that expenses generated by unregulated parts of the company were being transferred to the books of Duke's utilities. Regulators in North Carolina and South Carolina, where the utility units operate, hired Boston-based Grant Thornton LLC to conduct an audit. In October, the auditors concluded that Duke, which has become a large energy trader, had wrongly accounted for $124 million in expenses.

E-mail messages showed a protracted campaign by Duke accountants to shift expenses onto the utilities, according to the audit. The actions artificially depressed earnings at Duke's utilities. Grant Thornton suggested this had the effect of reducing the possibility that the utilities might earn more than their permitted rates of return. Excess earnings could have prompted regulators to order the utilities to make refunds to customers. They also could have moved to cut Duke's allowed rates of return from about 12% currently. Duke contested the audit, but agreed to pay $25 million to its utility customers to end the investigation without admitting wrongdoing.

Regulators might have overlooked the events at Duke if not for the inside tip. Neither of Duke's utilities has been subjected to a full regulatory review in more than a decade. Mignon Clyburn, chairwoman of the South Carolina Public Service Commission, says her agency has been criticized for "settling cheap" but complains, "we have no stick." Her agency employs just 80 people and has no fining authority.

Industry experts say such juggling of expenses by energy companies is occurring with greater frequency and often goes undetected by state regulators except when audits are conducted as part of rate cases. But rate reviews have become more sporadic in recent years. Like all public companies, energy concerns must file audited financial reports with the Securities and Exchange Commission. But the SEC doesn't check whether expenses are being shifted between regulated and unregulated units.

Many regulatory commissions are looking for ways to strengthen their oversight powers. A few states, including Oregon, Wisconsin, Virginia and New York, restrict the ability of holding companies to siphon money out of their regulated units. Wisconsin sets minimum capital requirements for its utilities, and requires rates and utility operations to be reviewed at regular intervals.

Still, a lack of manpower limits regulatory commissions from enforcing even tougher rules. Oregon, for instance, found this year that Enron, which bought Portland General Electric Co. in 1997, took $27 million out of the utility two years ago to which it wasn't entitled. Getting that money back now that Enron is under bankruptcy-court protection will be difficult, officials say.

"If we're one of the better states, that's a scary proposition for the nation," says Bob Jenks, head of the Oregon Citizens Utility Board, a Portland consumer group. "Things aren't really under control here."

APPENDIX D: Fitch's Credit Ratings for Selected Utility Companies

	Rating (Senior Unsecured) As of 12-02	Outlook As of 12-02	Gross Debt (in millions) As of 9-30-02
Registered Holding Companies			
Allegheny Energy Inc.	BB	Negative	$4,950
American Electric Power Company Inc.	BBB+	Stable	$13,103
CenterPoint Energy Inc.	BBB-	Negative	$9,900
NiSource Inc.	BBB	Negative	$7,861
Northern Indiana Public Service Co.**	A-	Negative	
Xcel Energy Inc.	BB+	Negative	$16,909
Exempt Holding Companies and Electric Utilities			
AES Corp.	B	Negative	$24,129
Indianapolis Power & Light**	BB+	Negative	
Aquila Inc.	BB	Negative	$3,568
CMS Energy Corp.	B+	Negative	$7,545
Consumers Energy Co.**	BB	Negative	
Constellation Energy Group	A-	Stable	$5,044
Baltimore Gas & Electric Co.**	A	Stable	
Duke Energy Corp.	A	Negative	$22,871
Dynegy Inc.	B	Negative	$7,139
Illinois Power Co.**	B	Negative	
Edison International	B	Positive	$14,784
Southern California Edison Co.**	BB-	Positive	
Pinnacle West Capital Corp.	BBB	Negative	$3,863
Arizona Public Service Co.**	BBB+	Negative	
TECO Energy Inc.	BBB	Stable	$3,525
Tampa Electric Company**	A-	Stable	
TXU Corp.	BBB-	Stable	$13,480

Category BB and below are speculative grade ratings.

** *Electric utility subsidiary of holding company listed immediately above.*

Source: *Fitch Ratings, "Outlook 2003: U.S. Power & Gas," December 17, 2002, and Web site, www.fitchibca.com.*